The World Currency System in 2030

Lawrence J. Lau, Ph. D.

Ralph and Claire Landau Professor of Economics, The Chinese Univ. of Hong Kong
and
Kwoh-Ting Li Professor in Economic Development, Emeritus, Stanford University

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Tel: (852)3550-7070; Fax: (852)2104-6938
Email: lawrence@lawrencejlau.hk; WebPages: www.igef.cuhk.edu.hk/ljl

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Introduction

- By 2030, Chinese GDP is likely to reach the same level as U.S. GDP, approximately 15% of total World GDP each.
- By 2030, Chinese international trade and U.S. international trade will also be approximately equal in magnitude, constituting between 10 and 15 percent of total World trade.

Three Large Currency Blocs

- There will likely be three large currency blocs: the U.S. Dollar Bloc, which will likely include the economies in North and South America, the Euro Bloc, which will likely include almost all of Europe, including Russia, North Africa and the Middle East; and the East Asian Currency Bloc, with relatively stable exchange rate parities within each bloc, and also relatively stable exchange rate parities among the three blocs. The inter-bloc exchange rate parities are maintained within a band by prior agreement by the blocs concerned, using the incentive-compatible method proposed by Professor Robert Mundell, that is, whichever bloc that has too strong a currency will take responsibility for selling it down.

Three Large Currency Blocs

- It is not clear where Southern Africa, South Asia and Australia will fit in, but by that time there will probably be a South Asian Currency Bloc as well.

A Return to a Bretton-Woods-Like System among the Currency Blocs

- Inflation-indexed bonds denominated in local currencies issued by the individual economies within each bloc will be used to settle balance of payments surpluses and deficits among themselves.
- A central bank holding the long-term inflation-indexed bonds of another economy does not need to worry about the relative exchange rate because it can always purchase the same quantity of real goods that it could have purchased at the time it acquired the bonds. So it would not suffer any real loss.
- Inflation-index bonds issued in U.S. Dollars, the Euro and the Yuan can be used to settle inter-bloc imbalances. These bonds should also be available within the blocs themselves to all citizens . This will lessen the probability of potential default than if they are only available to foreign holders.

A Return to a Bretton-Woods-Like System

- Periodic adjustments in the intra-bloc relative exchange parities and the inter-bloc relative exchange rate parities are made in response to differentials in the rates of inflation and persistent balance of payment surpluses and deficits.
- On the one hand, there is no single dominant international reserve currency. On the other hand, the relative exchange rate parities are relatively stable in real terms and adjusted only periodically in response to persistent imbalances.

Concluding Remarks

- The stability of the global monetary system will be enhanced with the reduction in the volatility of relative exchange rates.
- The ability of economies to borrow in their own local currencies also greatly reduces the possibility of currency-mis-match and possibly also maturity mis-match, two of the major causes of financial crises.
- With relatively stable relative exchange rates, World trade and cross-border direct and portfolio investment will grow significantly, bringing real benefits to all economies.